

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code 140.101. (This is a PLR).

August 30, 1999

Dear XXXXXX:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter of June 25, 1999. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the enclosed copy of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

We would like to obtain a Private Letter Ruling regarding what we feel is a very gray area. A General Information Letter was sent to us on February 25, 1999 regarding the same situation. However, we would like a binding opinion regarding this situation. A copy of the General Information Letter is enclosed for reference. Following is information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110:

1. I represent my client, COMPANY located in CITY, Illinois. My client is an interstate carrier for hire and owns and operates a distribution service company. COMPANY is currently registered with the Illinois Department of Revenue for sales tax. My client provides his customers with the service of warehousing, packaging and mixing of plastic pellets. My client never owns, nor sells the plastic pellets, he simply provides warehousing and packaging services.

In order to provide these services, certain supplies are required. Large cardboard boxes, each holding 1,000 pounds of bulk plastic pellets, lids, liners and wooden skids are utilized in completing the customer needs. The supply items are never returned to my client.

After the packaging process, my client transfers the plastic pellets, which are contained and shipped in the cardboard box, plastic liner, lid and wood pallet or wood skid. This product is then shipped to the pellet company's customer, which is always a manufacturer. The pellet company then bills his customer for the pellets, and we bill the pellet company for the processing service and the packaging products.

Our wooden pallet supplier, BUSINESS recently underwent an Illinois sales tax audit. The results from this audit were that BUSINESS was to collect Illinois sales tax from us on the pallets sold, unless we provided them with a valid resale certificate. In addition to the pallets, our other supplies are purchased from both in-state and out-of-state suppliers. The customers who purchase these services from my client are also located both in-state and out-of-state.

Be advised, my client always provides these services to a manufacturer, never to the final customer.

We feel confident that we qualify as a serviceperson when providing this service to our customers. Our cost of goods transferred is less than 35% of our total service revenue.

2. Reference is made to the Illinois Department of Revenue letter dated February 25, 1999, which is enclosed herewith. No contracts, licenses, agreements, or instruments exist between my client and his customers.
3. There is no specific tax period at issue. We would like an opinion regarding present and future tax matters for this specific situation. No audit or litigation pertaining to our client is pending with the Department.
4. To the best of taxpayers and representative's knowledge, the Department has not previously ruled on the same or a similar issue for the taxpayer or predecessor. Taxpayer and his representative have not previously submitted the same of similar issue to the Department, in request of a Private Letter Ruling. However, as mentioned above, a General Information Letter was issued regarding this situation and is enclosed herewith.
5. No statement of authority is submitted herewith other than an application of the law as taxpayer understands it to the facts as stated.
6. Taxpayer is unaware of any other authority which is contrary to taxpayer's view.
7. There is no identification of any trade secrets in this matter.
8. Enclosed is Power of Attorney from PERSON granting the undersigned authority to represent him in this matter.

Our questions are as follows:

Questions #1: Are we required to pay sales tax when we purchase the cardboard boxes, lids, liners and wood pallets used in fulfilling the customers order? We never reuse or receive back any of the supplies used. We bill the customer for supplies used and for a service of processing the plastic pellets. We simply warehouse, mix, package and ship the plastic pellets for our customer, and bill the customer for the mixing services and packaging materials. (The tangible personal property transferred is slightly marked up).

Question #2: Should we collect sales tax from the customer on the tangible personal property transferred with this service?

Based on the above explanation, we respectively request a letter ruling on our particular situation. Your response will be greatly appreciated for clarification and direction.

In your letter you indicate that your client, COMPANY is performing a service of warehousing, packaging, and mixing of plastic pellets and that the cost of goods transferred is less than 35% of your client's total service revenue. You have indicated that your client is currently registered for sales tax purposes. The letter further indicates that the items your client transfers as an incident to a sale of service include cardboard boxes, plastic liners, lids and wooden pallets or skids.

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

You have indicated that your client is registered and is a de minimis serviceman. Therefore, your client would utilize the third method of accounting for tax liability. Please note that the third way servicemen account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. As you know, servicemen may qualify as de minimis if they determine that their annual

aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f) enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. Therefore, when you purchase the cardboard boxes, lids, liners and wood pallets used in fulfilling the customers orders, you are not required to pay tax to the supplier. You should give your supplier a Certificate of Resale.

Please note that if your client was not registered with Illinois or was not required to be registered with Illinois, then the fourth method of accounting for tax liability would apply. De minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act may use the fourth method of determining tax liability. Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Therefore, when you purchase the cardboard boxes, lids, liners and wood pallets used in fulfilling the customers orders, you are required to pay your supplier Use Tax or remit the Use Tax to the Department if you purchase these items from unregistered out-of-State suppliers.

If circumstances change and your client no longer qualifies for de minimis status, your client would have the option of using either the first or second methods. Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. Under both of these methods, you are not required to pay tax to the supplier when you purchase the cardboard boxes, lids, liners and wood pallets used in fulfilling the customers orders. You should give your supplier a Certificate of Resale.

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The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.